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DOW THEORY LETTERS

"THE MARKET AS INTERPRETED UNDER THE DOW THEORY"

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AN INCREDIBLE ADVANCE. I do not know of a comparable advance in stock market history. We have now had a move of 114 points without a serious reaction, and the public is still skeptical. My broker readers report no tremendous pressure for investment from their customers, and the unbelievable odd-lot (under 100 shares) figures still show the public selling out during this entire advance. The big investor, of course, has been buying. True, the international news has been frightening, and each time the crowd decides to buy stock something arises which causes them either to hold back or to take profits (or losses). And lately the prices of stocks themselves have served to scare the public. They believe stocks are just "too high." It will take time before the crowd gets used to the new "high" prices, but I believe they will succumb. Ask about, find out how many of your friends have held their securities throughout this whole tremendous upsurge. Under Dow Theory there was a mountain of evidence pointing to the fact that this was a "buy" period, and has been all along. Hamilton said that he "never knew a time when the majority of professional opinion was right," and it must be admitted that this aphorism has held up magnificently in the last year. This statement sounds cynical, but everybody in the market has access to some sort of professional advice. Over a long period, few make money.

SOMEWHERE AHEAD. Bullish, optimistic predictions are a pleasure to write, and even more of a pleasure when they come true. Readers have had their share from me on that count lately. Yet like drivers in heavy traffic, we must look ahead. Every ten points higher is ten points nearer the next secondary reaction. Secondaries tend to correct and retrace 1/3 to 2/3 of the preceding uncorrected primary advance. They tend to last three weeks to three months. Dow Theorists should become increasingly wary as an advance continues. We know that the crowd becomes increasingly bullish. Secondaries come with little warning, usually at a time when they are least expected and when the crowd is buying greedily.

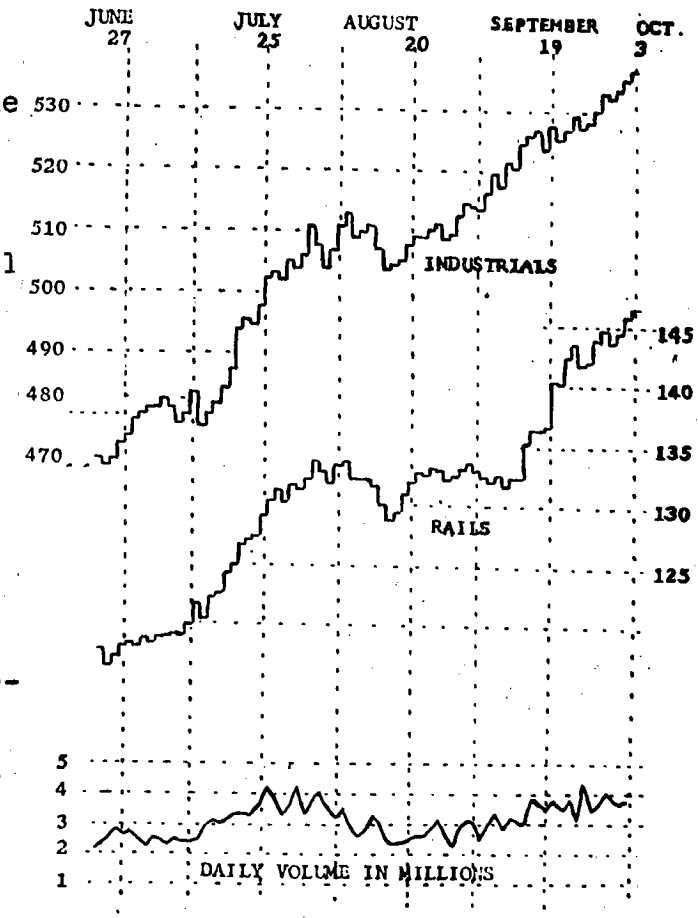
WHAT ARE THE SIGNS. After a prolonged advance, one or more of these signs may "tip-off" a secondary reaction. (1) Following a decline (defined as about a 3% drop), an advance commences in which one or both averages fail to go over the previous high, and then the two averages go below their previous decline level on increasing volume. (2) Both averages break a "line" downside (a line is a formation in which each respective average remains within a 5% area for at least two weeks). (3) One average declines persistently while the other advances. (4) Excessive volume (relative to what preceded) with little or no advance in the averages. (5) One average goes to a new high but the other refuses to confirm or agree. One or more of these signs usually appears before a reaction. However, if one of these signs appears it does not necessarily mean that a reaction will follow. This area of market prediction is one of the trickiest and most difficult with which we have to contend.

HOW STEEP A REACTION. If, for the sake of an example, the present upsurge continues to 580, a secondary reaction might correct 1/3 to 2/3 of the entire advance since the Oct. 1957 lows of 419. A 1/3 correction would carry the industrials to 527, a 2/3 correction would take them to 472. These retracements would be normal. It is entirely possible that a reaction might only correct 1/3 to 2/3 or the advance since the "line" at 512. We do not and can not know. But we do know that sooner or later a reaction must come.

We should remember that the second phase, not the third phase (which we are now in), usually has the most deceptive and severe secondary reactions.

WHAT TO DO. People who want to be safe are not obliged to buy common stocks. The market has its risks. So does a savings bank when inflation runs rampant. When a secondary is upon us we can elect to "ride it through" or take our profits and pay the taxes. Or we can do both. Unfortunately, we never know whether we are going to get a minor decline or a severe secondary. I feel that the third phase has still a few years to go. There are now tremendous cash balances on the side lines in banks, savings and loans, and brokerage accounts. This market does not appear over-bought. The averages show no signs of a reaction at this writing. I believe the country has been "caught" in an under-invested position. I would expect odd-lot buying to come in strongly and the crowd to be openly bullish before our next reaction. Eventually, the odd-lotter always buys an advancing market.

DOW THEORY. The labor leader who knew there would be an auto peace and bought motor stocks, the industrialist with connections in China who knew more of Mau's intentions than the state department itself, the insiders who knew that Russia would limit her aluminum sales in the European market, the thousands of informed investors who bought stocks recently, again proved that the averages contain more intimate knowledge than the second guessing of a fearful public. During the past scare-laden week the averages pushed to new highs as rails and industrials moved "in gear" in their typical "up-two, down-one" motion. It is of interest that since the "line" breakout of Sept. 15 (see chart) the country seems to have become more optimistic. One hears few really bearish statements now, and it seems as if the breakout silenced the worst of the pessimists. It remains for the crowd to "see" what the most pessimistic of the professional bears are finally recognizing, that we are headed into a boom. As to the magnitude of the coming boom, the public is still unaware. It is possible that we will get another consolidation period such as the mid-August move in the very near future.



STOCKS. As predicted in these letters, the oils and coppers finally stepped out last week, proving that all values eventually join in a great market advance (bull swing), each group in its own good time. It seems to me that the following are still undervalued: ANACONDA, AMERICAN SMELTING, KENNECOTT, INTERNATIONAL NICKEL, KAISER ALUMINUM, REYNOLDS, ATLANTIC REFINING, CITIES SERVICE, STANDARD OF JERSEY AND INDIANA, PURE OIL, SINCLAIR, CRUCIBLE STEEL, WHEELING, SYLVANIA, WESTINGHOUSE, W.R.GRACE, JOHNS MANVILLE, DUPONT, DOW CHEMICAL.
SPECULATIONS: SYMINGTON WAYNE, BALDWIN LIMA, CONTINENTAL MOTORS, HUPP, SPARTON, ADMIRAL, AMERICAN CABLE, AVCO.

I like well diversified lists and definitely recommend odd-lots in smaller accounts, where diversification is needed fully as much as in larger accounts. There is nothing more disheartening than sitting out a move with the one or two stocks that lag behind the market.